Domestic demand fuels Spain´s economic recovery

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Spain´s recovery is gradually picking up speed. Global risks remain, but in the context of the favorable external financial environment, the outlook for 2014 and 2015 has improved.

The first half of 2014 has been marked by the strength of global financial markets and increased risk appetite in the context of abundant liquidity. A re-assessment of risk and the withdrawal of the Fed´s quantitative easing could cause a fresh bout of instability. In Spain, the economic recovery is gaining strength and risk premiums on Spanish debt are at their lowest levels since the Greek crisis broke out in May 2010. Post-crisis growth drivers have inverted, with domestic demand making a strong contribution, but prompting the external sector´s negative performance – a consequence that is neither desirable nor sustainable. Moreover, employment is on the rise. At the same time, progress on deficit reduction seems inadequate relative to agreed-upon targets for the year. Despite risks, in view of the positive external financing climate, GDP forecasts have been revised upwards for both 2014 and 2015 to 1.4% and 2.2%, respectively.

External context

The external context during the first half of 2014 has been marked by the strength of global financial markets, with stock market indices rising significantly, and public and private debt yields falling, along with the risk premium. This is explained by the search for yields in the context of abundant liquidity resulting from the strongly expansionary monetary policies in place in the United States, the United Kingdom and Japan. On top of this came expectations in the spring that the European Central Bank would also take more aggressive monetary policy measures.

However, this situation is not without its risks. There is a fear that the markets are not assessing risk properly, and that many assets are overpriced. Thus, should an event occur that leads to a re-assessment of these risks, fresh bouts of instability could ensue. There is also uncertainty about the possible destabilising effects of the Federal Reserve’s withdrawing its quantitative easing measures, particularly as interest rates start to edge upwards. This could happen sooner than expected –as early as mid-2015– given the ascendant trend in inflation. By contrast, the possibility of a resurgence of the European debt crisis can be almost entirely ruled out after the latest measures announced by the ECB.

The expectations that the ECB would adopt a more aggressive monetary policy stance were finally fulfilled. At its meeting on June 5th, the institution decided, among other things, to cut its interest rate on main refinancing operations, set a negative

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interest rate for deposit facilities, and launch a new programme of so-called TLTROs to supply financial institutions with liquidity conditional upon their granting non-mortgage credit to families and firms. This was all intended to prevent prolonged, excessively low levels of inflation and to reduce the segmentation of Europe's financial markets.

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Moreover, the recovery in developed countries has continued to progress at a moderate pace. The United States suffered a 2.9% drop in GDP in the first quarter (on an annualised basis) due, to a great extent, to the impact of the adverse weather conditions last winter. According to the economic indicators, its economy continued to grow steadily, although the property market lost momentum somewhat and the inflation rate is hovering around 2%. Japan experienced a sharp rise of 6.7%, although this was short-lived, being the product of purchases being brought forward ahead of a consumption tax rise due in April.

In the euro area, where inflation remained extremely low throughout the first half of the year (between 0.5% and 0.8%), GDP growth was a disappointing 0.7% in the first quarter (also on an annualised basis) and the available indicators for the second quarter hardly herald an improvement. The United Kingdom kept up its vigorous growth rate, with quarter-on-quarter rates of around 3% over the last four quarters, which has led the Governor of the Bank of England to warn that interest rates could start to rise earlier than previously anticipated.

The situation in the emerging countries is calm at present, benefiting from global financial markets' optimism following the turbulence in the first few weeks of the year. Nevertheless, uncertainty lingers over the possible impact on their economies of the progressive withdrawal of quantitative easing in the United States, accompanied by the risk of new outbreaks of instability, compounded by the structural decline in emerging countries' growth potential.

Recent developments in the Spanish economy

GDP grew by 0.37% in the first quarter of 2014, equivalent to 1.5% on an annualised basis (the basis on which all growth rates below will be expressed). The year-on-year increase was 0.5%.

This quarter-to-quarter growth was the result of a positive contribution from national demand of 4 percentage points (pp) and a negative contribution from the external sector of -2.5 pp. The latter was the result of a drop in exports in real terms and an increase in imports stimulated by growth in domestic demand. This pattern of contributions to growth represents an inversion of the pattern commonly seen since the start of the crisis, characterised by a negative contribution from national demand and positive contribution from the external sector. This change has also been seen in the year-on-year GDP growth rate, something which has only happened once during the period, namely in the second quarter of 2010.

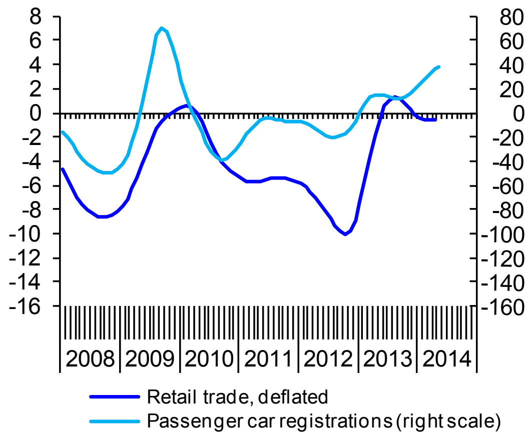
Private consumption rose for the fourth consecutive year, growing by 1.7%. This growth was mainly the result of the upward trend in consumer goods consumption. The indicators available for the second quarter suggest a continuation of the upward trend in this variable. The consumer confidence index made particularly good progress, returning to 2001 levels, as did the consumer goods order book. New vehicle registrations also continued to increase rapidly, influenced by government incentives (Exhibits 1.1 and 1.3).

Exhibit 1

Consumption and capital goods investment indicators

1.1 - Consumption indicators (I)

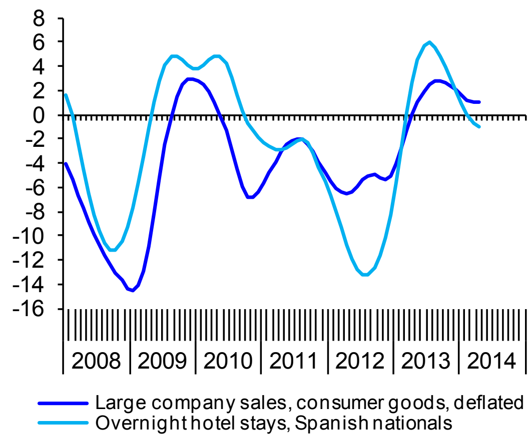
Annualised moving quarterly change in %, smoothed series



Sources: INE, DGT and FUNCAS.

1.2 - Consumption indicators (II)

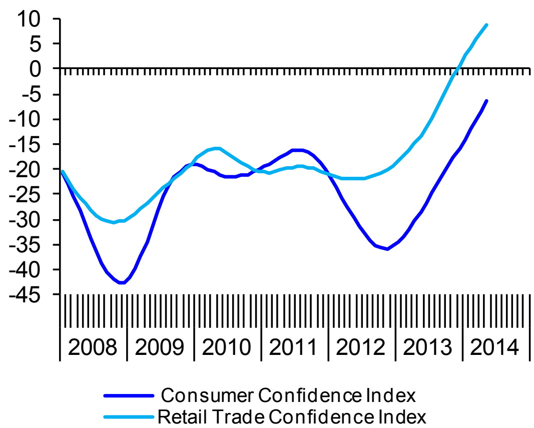
Annualised moving quarterly change in %, smoothed series



Sources: INE, AEAT and FUNCAS.

1.3 - Consumption Indicators (III)

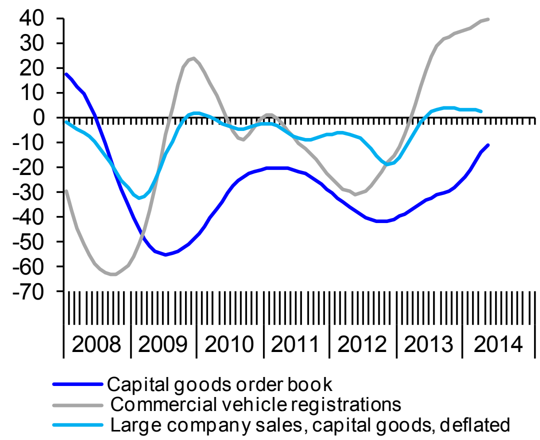
Index, smoothed series



Sources: European Commission and FUNCAS.

1.4 - Capital goods GFCF indicators

Annualised moving quarterly change in %, smoothed series



Sources: Ministry of Industry, AEAT, DGT and FUNCAS.

Public consumption rose by 18.9%. However, quarter-on-quarter rates of seasonally adjusted figures for this latter component of demand should be interpreted with caution, as the seasonal adjustment may be distorted by changes last year in the way current public expenditure is accrued or deferred in the accounts. In fact, this strong increase should offset the sharp drop of 14.6% registered last quarter. The strongest sign of the trend in this aggregate is therefore the year-on-year rate, which stood at -0.2% in the first quarter.

The drop in the construction component of gross fixed capital formation accelerated to -12.5%. The adjustment in home building continued, although there was a trend towards a slowing in the rate, while investment in other construction was unable to sustain the upturn in the final quarter of 2013 and returned to strongly negative rates. The property market is starting to show signs of stabilization, in terms of both prices and sales: the rate of decline in prices has slowed considerably, and even, according to the INE's price statistics, that of new houses stopped falling in the first quarter of this year; as regards housing transactions, slight growth has already started to be seen.

Investments in capital goods and other products grew by 10.8%, making this the fifth consecutive quarter of growth. Growth in investments in transport equipment stands out in particular, in parallel with the progress of registrations of cargo vehicles, which even picked up speed in April and May. The order book for capital goods has also undergone a substantial improvement over that period, which all suggests that the vigorous growth rate of this component of demand is likely to be maintained during the second quarter (Exhibit 1.4).

Total exports, which over the last two quarters of 2013 had already lost a certain amount of momentum, fell in the first quarter of 2014, although exports of non-tourism services continued to grow vigorously. Imports rose strongly, reflecting the recovery in durable goods consumption and investments in capital goods. Both variables were up in year-on-year terms, but imports rose more than exports for the first time since the second quarter of 2010. In the second quarter, only customs data for April are available. These show a recovery in exports, with their growth outpacing that of imports. Nevertheless, it is still too soon to say whether this means a return to a more positive trend (Exhibit 3.1).

From a supply-side perspective, GVA in farming repeated the good results obtained in the previous quarter. Industry registered a contraction, although this was due to the decline in activity in the energy industry, while manufacturing made good progress. The growth of the latter could even speed up in the second quarter, as heralded by the industrial production index, the turnover index, sales of large industrial enterprises in April, and the PMIs. Even social-security system registrations began to grow in this sector (Exhibits 2.1 and 2.2).

GVA also grew in market services, and PMIs picked up speed in the second quarter, as did the sector's confidence indicators, activity indicator, and social-security registrations (Exhibits 2.3 and 2.4). Construction also contracted further, following the moderation observed in the preceding two quarters, contrasting with the improvement registered by indicators such as cement consumption, which has stabilised, or social security registrations in construction and construction materials IPI, which are now improving (Exhibits 2.5 and 2.6).

Employment, measured in terms of full-time equivalent jobs, grew by 0.5%, making for two quarters of growth. This result is in line with the change in social security registrations, which also grew in the first quarter –although more intensely than suggested by the CNTR figures–, while the Labour Force Survey (LFS), on the other hand, indicated a fresh drop in employment. Whereas the number of social security registrations is a solid and reliable statistic, the LFS, being survey-based, is subject to a margin of error, so, given the modest amount of the fall, in this case, the first quarter result is not inconsistent with employment growth (Exhibits 4.1 and 4.4).

Moreover, according to the social security registration figures, employment continued to rise, with the pace accelerating in April and May across many sectors –including construction–, which is another sign that the rate of GDP growth picked up during the period.

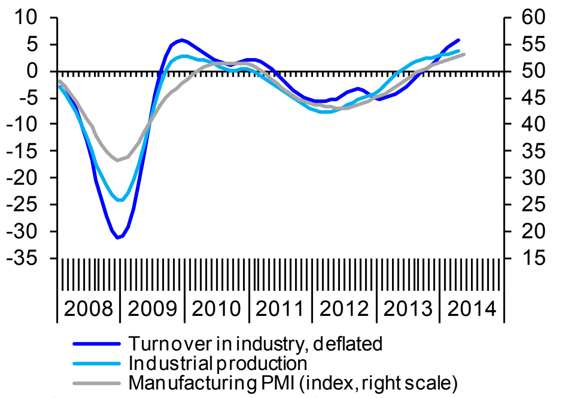
Labour productivity improved by 0.9% across the economy as a whole and 5% in manufacturing, while compensation per employee dropped, such that unit labour costs fell once again across

Exhibit 2

Industrial activity, services and construction indicators

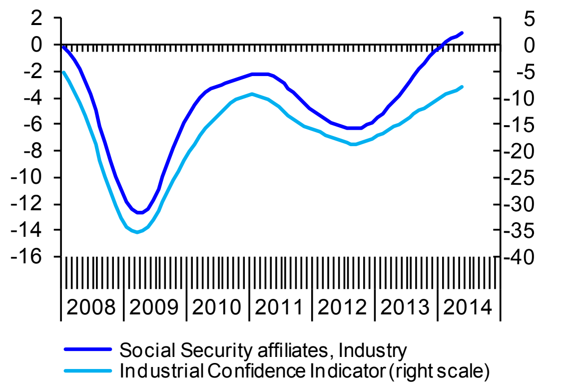
2.1 - Industrial sector indicators (I)

Annualised moving quarterly change in % and index, smoothed series



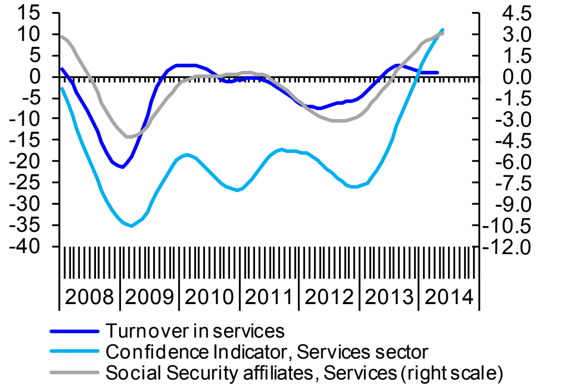
2.2 - Industrial sector indicators (II)

Annualised moving quarterly change in % and index, smoothed series



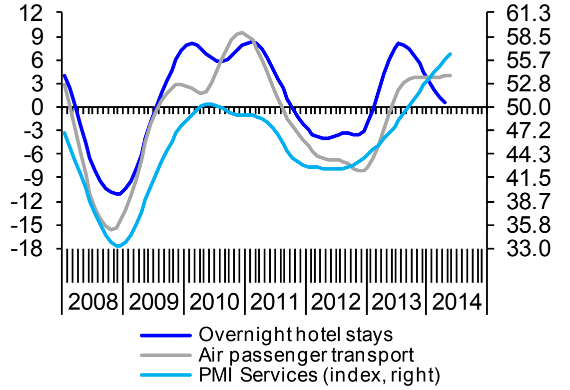
2.3 - Services indicators (I)

Annualised moving quarterly change in % and index, smoothed series



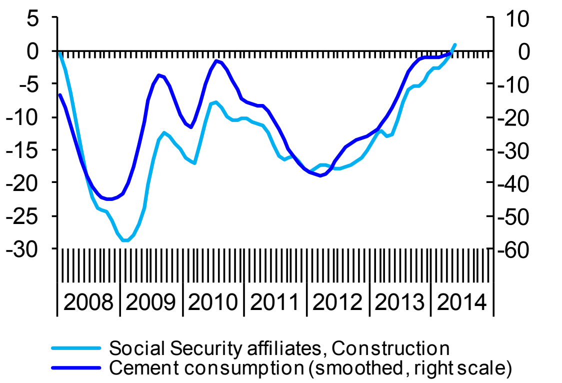
2.4 - Services indicators (II)

Annualised moving quarterly change in % and index, smoothed series



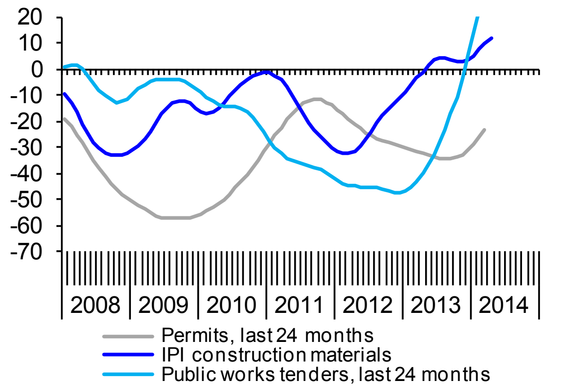
2.5 - Construction sector indicators (I)

Annualised moving quarterly change in %



2.6 - Construction sector indicators (II)

Annualised moving quarterly change in %, and index, smoothed series



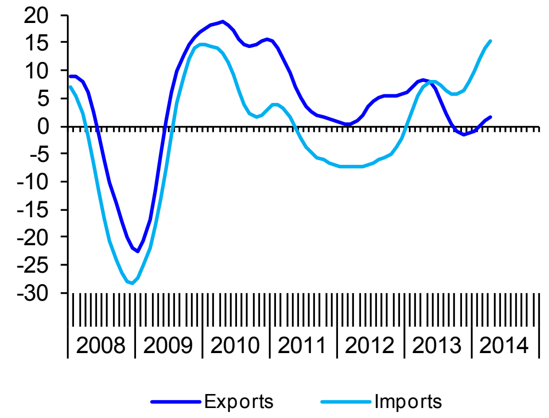
Sources: European Commission, Ministry of Labour, Ministry of Public Works, INE, AENA, Markit Economics Ltd., SEOPAN, OFICEMEN and FUNCAS.

Exhibit 3

External sector

3.1 - Exports/Imports at constant prices (Customs)

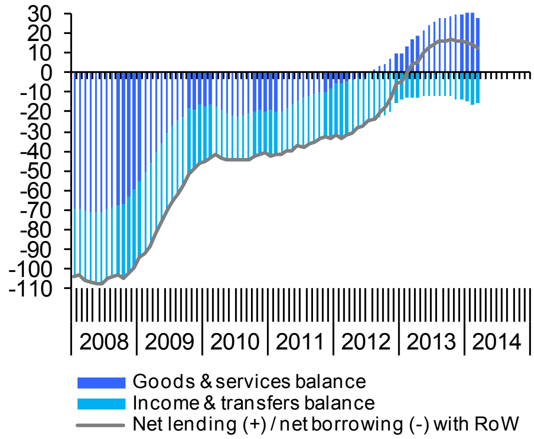
Annualised moving quarterly change in %, smoothed series



Sources: Ministry of Industry and FUNCAS.

3.2 - Balance of payments

EUR billion, cumulative last 12 months



Source: Bank of Spain.

the economy as a whole, and particularly in manufacturing.

The trade balance worsened in the first quarter compared with the same period of the previous year, a situation which has not occurred since mid-2010, as a result of the rise in imports linked to the recovery in consumption and capital goods investments. Consequently, the current account balance also worsened. Looked at in terms of the balance between domestic savings and domestic investment, this was the result of the savings rate falling faster than the investment rate (Exhibits 3.2 and 5.1).

The national savings rate held up at the start of the year, prolonging the downward trend that began as the economy began to recover in the third quarter of 2013, which put an end to the upward path maintained throughout 2012 and into the first half of 2013, although each component has progressed very differently. Thus, the increase in the savings rate mainly came from businesses, whose savings rate has grown strongly over the last two years (Exhibit 5.2). Specifically, in 2013 corporates' savings rose by 18.1%, basically as a result of falling salary and wage payments and interest (thanks to both the drop in the interest rate and the shrinking stock of debt).

Businesses' lending capacity almost tripled in 2013, rising from 1.1% of GDP to 4.3% of GDP, as a consequence of the strong growth in their savings and the falling investment rate. As in the previous year, along with the net proceeds of sales of financial assets, this financial surplus was entirely devoted to reducing businesses' debt. At the end of 2013, this debt stood at 129% of GDP, 4.6 pp down from the previous year, and 14.6 pp below its 2010 peak (Exhibit 5.3).

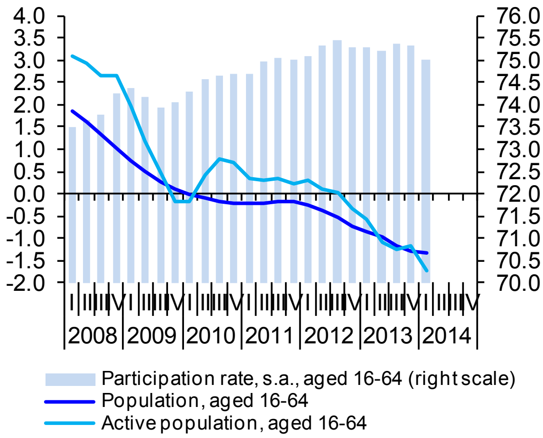
Households also generated a growing financial surplus in 2013, which was mostly used to shrink their stock of debt, and to a lesser extent by making net financial asset purchases. The rate of the reduction in household debt has gained pace over the last three years, such that at the end of 2013, debt was 116.5% of disposable income, 12.1 pp less than the peak reached in 2010 (Exhibit 5.3).

Exhibit 4

Labour market indicators

4.1 - Labour supply

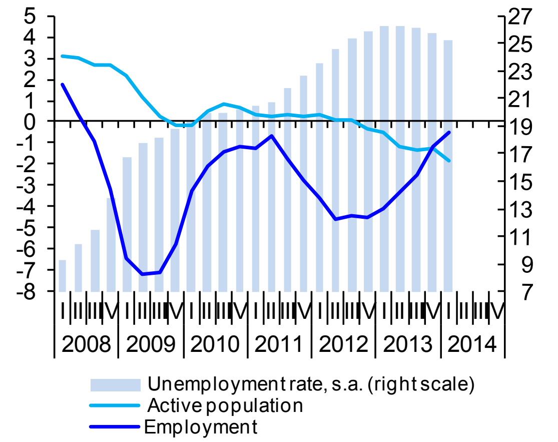
Change y-o-y in % and percentage of population aged 16-64



Sources: INE (LFS).

4.2 - Employment and unemployment (LFS)

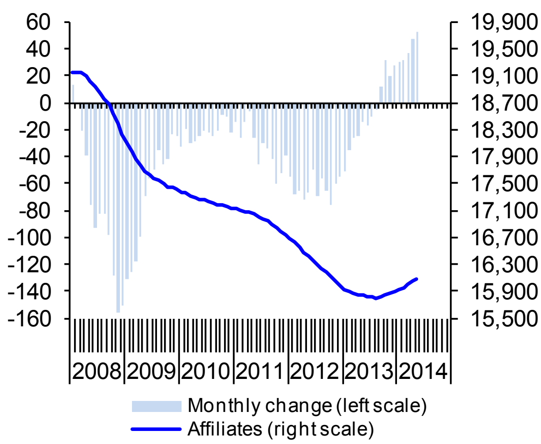
Change y-o-y in % and percentage of working age population



Sources: INE (LFS).

4.3 - Social Security affiliates

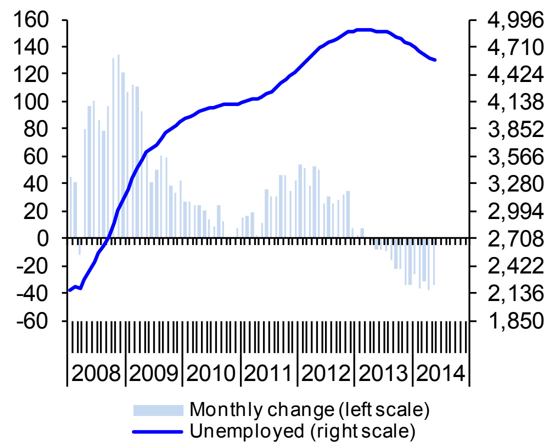
Thousands, seasonally-adjusted data



Sources: Ministry of Labour and FUNCAS.

4.4 - Registered unemployment

Thousands, seasonally-adjusted data



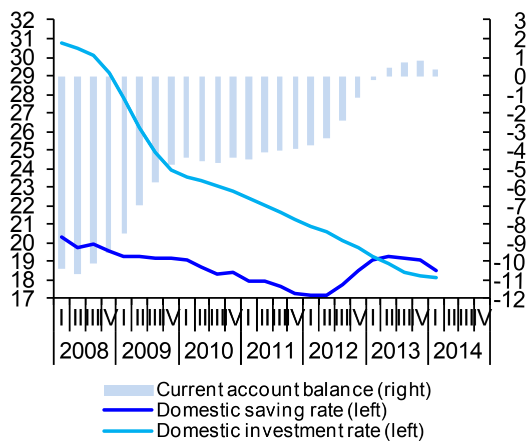
Sources: Ministry of Labour and FUNCAS.

In the case of the general government, excluding local authorities, total tax revenues grew by 2.7% in the first quarter of 2014, compared with the same period of the previous year (in the case of the central government alone, this increase was 5.1%). Total expenditure dropped by 0.1%, due to reduced social-security benefit spending and current transfers to other public administrations, while interest expenses rose at a rate of 5%. The deficit stood at 0.7% of GDP, one tenth of a percentage point lower than in the same period the previous year. The progress made in the first quarter looks inadequate given that the target for the year as a whole is to reduce the deficit (excluding

Exhibit 5
Financial imbalances

5.1 - Domestic saving, investment and current account balance

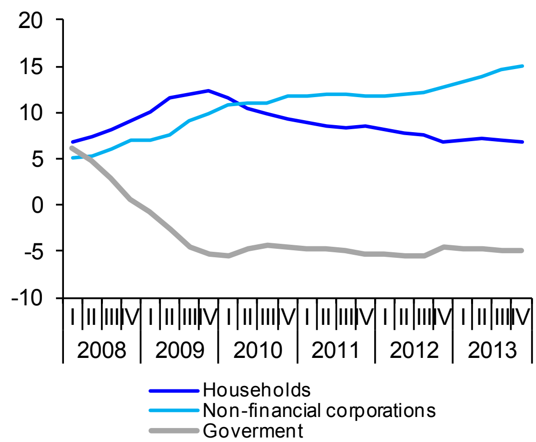
Percentage of GDP, 4-quarter moving average



Source: INE.

5.2 - Saving rates

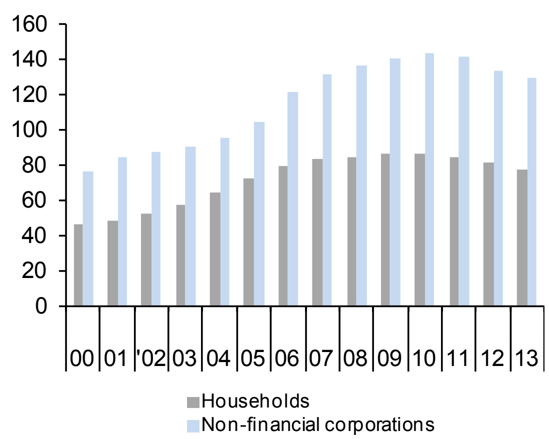
Percentage of GDP, 4-quarter moving average



Source: INE.

5.3 - Gross debt

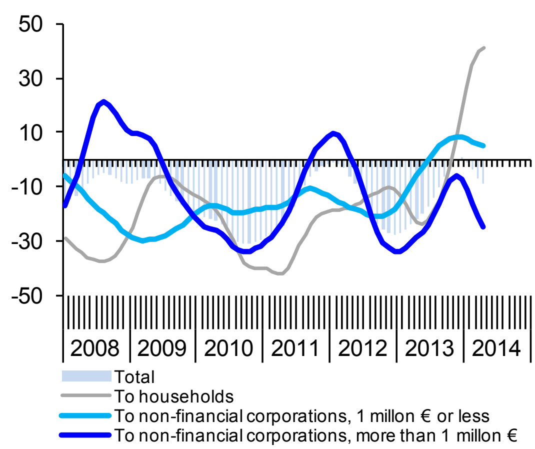
Percentage of GDP



Source: Bank of Spain (Financial Accounts).

5.4 - New business loans

Annualised moving quaterly change in %, smoothed and s.a. series



Sources: Bank of Spain and FUNCAS.

aid to financial institutions) from 6.6% of GDP to 5.5%. Broken down by level of government, this balance is distributed as follows: -0.75% of GDP from the central government, 0.3% from the social security system (entirely seasonal), and -0.25% from the autonomous regions.

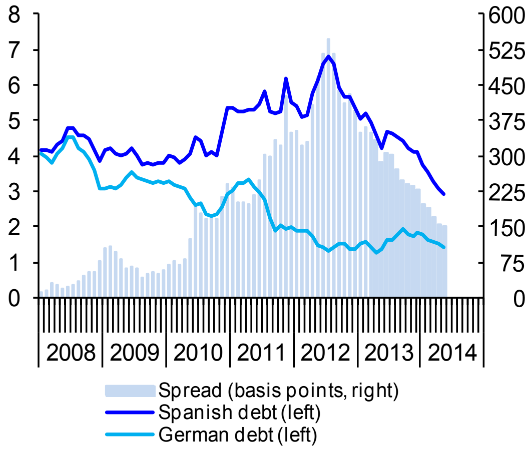
As regards the financial account of the balance of payments, foreign direct investment inflows in the first quarter of the year were less than those in the same period of the previous year, as was the case for other investments, while the investment portfolio progressed more favourably than a year

Exhibit 6

Financial indicators

6.1 - Government 10 years bonds rate

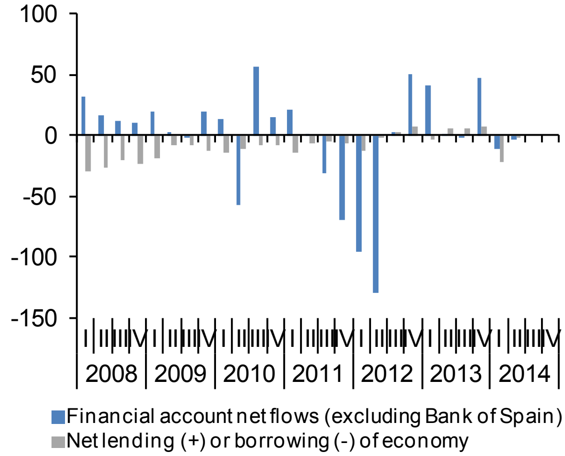
Percentage and basis points



Sources: ECB and FUNCAS.

6.2 - Balance of payments

EUR billion



Source: Bank of Spain.

earlier. The total net balance on the financial account, excluding the Bank of Spain, was -10,500 million euros, compared with a balance of 41,500 million euros registered in the same period of 2013 (Exhibit 6.2).

The return on Spanish sovereign debt has continued to fall, reaching historic lows. In recent weeks, the five-year rate has hovered around 1.4% and the ten-year rate around 2.7%, with the risk premium around 140 bps, its lowest level since the Greek debt crisis broke out in May 2010.

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Inflation also remains at historic lows. In May, the general rate stood at 0.2% and core inflation at 0% (Exhibit 7.1). Over the first five months of the year, the rate of inflation of prices of foodstuffs, particularly unprocessed foodstuffs, dropped fastest, while energy product prices rose, particularly in April and May. Despite the recovery in demand, it was still insufficient to push up prices, and the supply side was free of tensions, due to the spare productive capacity and falling labour costs.

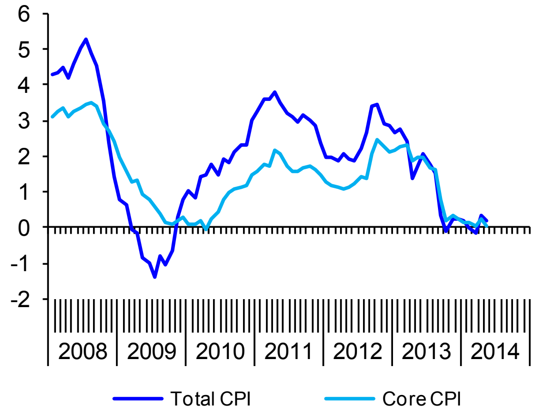
New credit to households and small and medium-sized enterprises continued to grow during the early months of the year. In the case of households, increases were registered in both consumer credit and lending for home purchases. Mortgage lending has grown surprisingly quickly, although admittedly from very low levels: the current volume is just 15% of that attained in 2006 (Exhibit 5.4).

Exhibit 7

Price indicators

7.1 - Consumer Prices Index

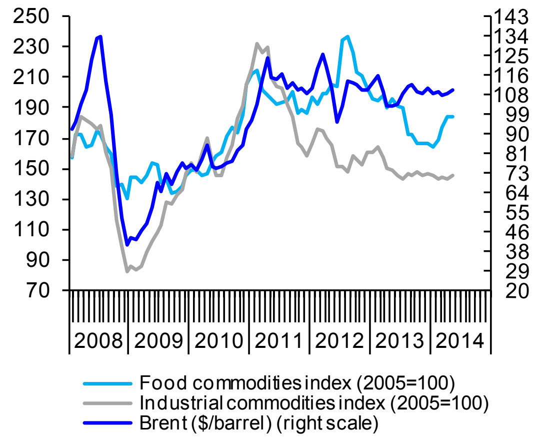
Change y-o-y in %



Source: INE.

7.2 - Commodities prices in $

Dollars and index



Sources: Ministry of Economy and The Economist.

Forecasts for 2014-2015

Performance in the first quarter was broadly as expected, although there was a change in sign in the progress of the external balance, and consequently, in its contribution to GDP growth. This is neither desirable nor sustainable, as the process of reducing debt levels –which is still a long way from being complete– requires a financial surplus to be produced vis-à-vis the rest of the world. Therefore, among other factors, it is envisaged that the various expenditure aggregates will follow the current cyclical phase more closely, making their contributions to domestic demand and the external sector positive in both cases, although the latter will be considerably lower than that registered in the recession years, due precisely to the effect of the growth of national demand on imports.

Additionally, the steady improvement in financial conditions over the first half of the year, reflected in the way returns on public debt have dropped to historic lows, and in the drop in the risk premium, has gained traction since the measures agreed by the European Central Bank at its meeting on June 5th. The result will be easier access to finance, and above all, falling long-term interest rates on credit to households and firms, which are also likely to remain low for an extended period of time. This will considerably favour the Spanish economy's process of recovery, both through the stimulus for investment and reduced borrowing costs for firms, households and government.

The biggest risk comes from abroad, specifically, as mentioned, from the risk of gradual withdrawal of quantitative easing measures in the United States, together with the likely interest rate increase next year. These factors may lead to renewed financial market tensions, compounded by the potential risk of financial market asset bubbles bursting.

In view of recent trends and the external financial environment, the GDP growth forecast for 2014 has been reviewed upwards by two tenths of a percent to 1.4%. The forecast for 2015 has also been revised upwards, to 2.2%, four tenths of a percent higher than in previous forecasts (Table 1). The pattern of quarter-on-quarter change will be relatively stable, with rates in the 0.5%-0.6%

range, which in annualised terms represents a rate of between 2.0% and 2.5% (Exhibit 8.1).

Private consumption is expected to grow by 1.7%, supported by the increase in households' disposable income, which is set to enjoy a modest rise in 2014 for the first time since 2009, thanks to growing employment and rising non-wage income, together with the reduction in debt interest payments (Exhibit 8.3). This income growth will be slightly less than consumption growth, which means that the savings rate will drop to historic lows, at below 10% of disposable income. In 2015, there will be a little more room to increase spending, largely thanks to the recently announced income tax cut, which will make it possible to speed up consumption growth to 2.0% and at the same time enable a slight recovery in the savings rate. Estimated public consumption is set to drop 0.8% in 2014 and 0.5% in 2015.

Gross fixed capital formation in construction will moderate its rate of adjustment of -4.9% and -1.4% in 2014 and 2015, respectively, although this component of demand has been revised downwards –a larger drop than expected in previous forecasts– due to its worse than expected performance in the first quarter (Exhibit 8.3). The property market will bottom out this year, which will allow residential construction investment to start to recover in the second half of 2015. Investment in capital goods and other products, by contrast, has been revised upwards to 8.3% this year and 6.0% the next. This basically involves investment aimed at replacing productive capital, largely financed out of companies' own funds.

In short, national demand as a whole is set to register positive contributions to GDP growth for the first time since 2007, quantified at 1 percentage point in 2014 and 1.6 points in 2015.

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The growth forecast for exports has risen to 5% this year, primarily as a result of the upward revision of the growth forecast for export services, which are proving more vigorous than expected. The forecast for next year has also been revised upwards slightly to 5.3%.

The faster expected growth in domestic demand has meant import forecasts have been revised upwards, to 4.0% and 3.9% in 2014 and 2015, respectively. The combined changes in exports and imports means the external sector will make a positive overall contribution, although smaller than that seen in recent years (Exhibit 8.2).

In the case of employment, growth of 0.6% is envisaged this year, and 1.4% the next. This represents net creation of 90,000 full-time equivalent jobs in 2014 and 222,000 in 2015 (Exhibit 8.4). This will result in average annual unemployment rates of 24.5% and 22.6%, respectively. This implies a reduction in the number of unemployed of almost a million over these two years (fourth quarter of 2015 over fourth quarter of 2013). Around two thirds of this reduction will be due to the contraction in the working population (as a result of the decline in the number of people of working age) and a third will be due to the increase in the number of people employed.

Labour productivity will slow markedly relative to the rate of growth observed in recent years, but will still outpace increases in wages and salaries, such that unit labour costs will continue to fall, although at more moderate rates.

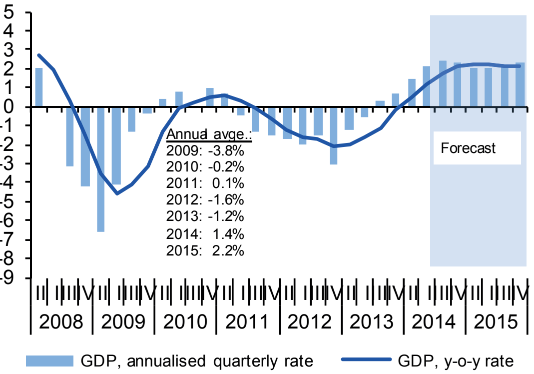
The current account of the balance of payments will generate growing surpluses, although the expected amount has been revised downwards to 1.1% of GDP in 2014 and 1.6% in 2015 (Exhibit 8.6). The public deficit –excluding aid to public financial institutions– will be cut this year to 5.5% of GDP

Exhibit 8

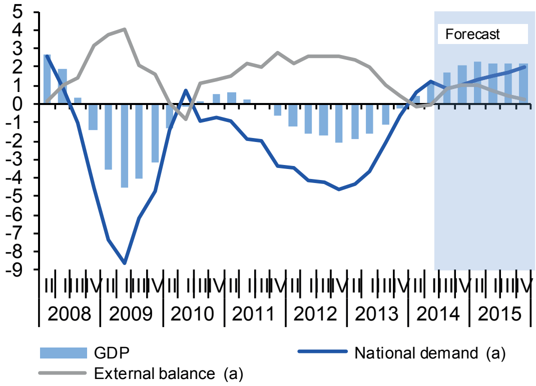
Economic forecasts for Spain, 2014-2015

Change y-o-y in %, unless otherwise indicated

8.1 - GDP

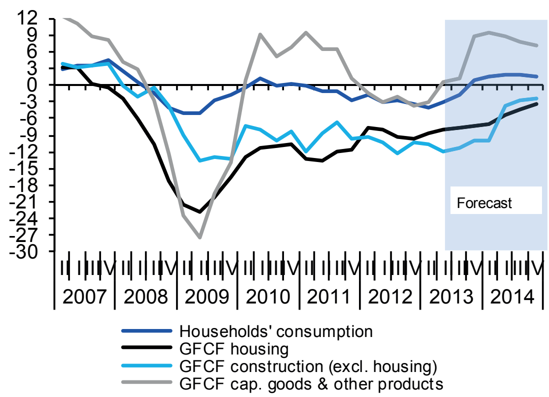


8.2 - GDP, national demand and external balance

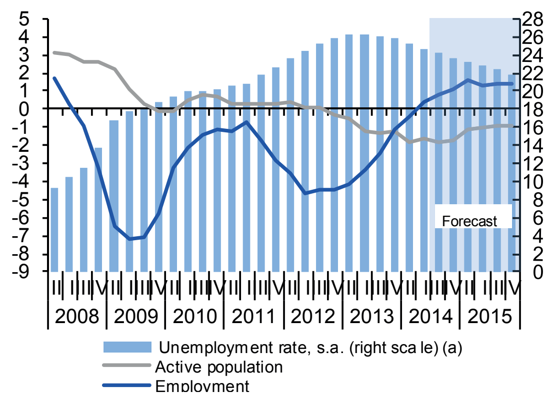


(a) Contribution to GDP growth in percentage points.

8.3 - National demand aggregates

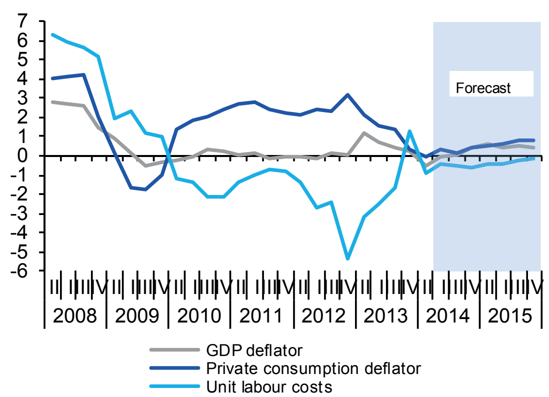


8.4 - Employment and unemployment

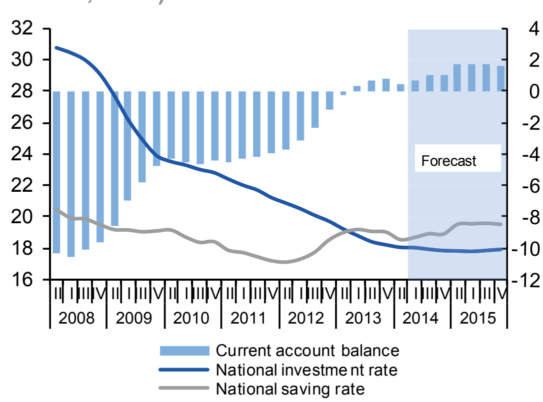


(a) Percentage of working age population.

8.5 - Inflation



8.6 - Saving, investment and c/a balance (% GDP, 4MA)



Sources: INE (Quarterly National Accounts) and FUNCAS (forecasts).

Table 1

Economic Forecasts for Spain, 2014-2015

Annual rates of change in %, unless otherwise indicates

	Actual data			FUNCAS forecasts		Change in forecasts (a)	
	Average 1996-2007	2012	2013	2014	2015	2014	2015
1. GDP and aggregates, constant prices							
GDP	**3.7**	**-1.6**	**-1.2**	**1.4**	**2.2**	**0.2**	**0.4**
Final consumption households and NPISHs	3.8	-2.8	-2.1	1.7	2.0	0.4	0.5
Final consumption general government	4.3	-4.8	-2.3	-0.8	-0.5	0.5	0.4
Gross fixed capital formation	6.2	-7.0	-5.1	0.8	2.1	0.1	-0.5
Construction	5.6	-9.7	-9.6	-4.9	-1.4	-3.0	-2.5
Residential construction	7.6	-8.7	-8.0	-5.1	-2.2	-0.3	-0.5
Non-residential construction	3.9	-10.6	-10.9	-4.8	-0.7	-5.1	-3.9
Capital goods and other products	7.4	-2.6	1.7	8.3	6.0	4.2	1.7
Exports goods and services	6.7	2.1	4.9	5.0	5.3	1.4	0.4
Imports goods and services	9.3	-5.7	0.4	4.0	3.9	1.7	0.4
National demand (b)	**4.5**	**-4.1**	**-2.7**	**1.0**	**1.6**	**0.3**	**0.4**
External balance (b)	-0.8	2.5	1.5	0.4	0.6	0.0	0.0
GDP, current prices: - € billion	--	1,029.3	1,023.0	1,036.9	1,064.8	--	--
- % change	7.4	-1.6	-0.6	1.4	2.7	-0.3	0.2
2. Inflation, employment and unemployment							
GDP deflator	3.6	0.0	0.6	0.0	0.5	-0.5	-0.2
Household consumption deflator	**3.1**	**2.5**	**1.3**	**0.2**	**0.7**	**-0.2**	**-0.1**
Total employment (National Accounts, FTEJ)	3.3	-4.8	-3.4	0.6	1.4	0.1	0.3
Productivity (FTEJ)	0.4	3.3	2.3	0.8	0.8	0.1	0.1
Wages	7.2	-5.6	-3.5	0.8	1.9	0.0	0.3
Gross operating surplus	7.3	1.6	1.3	1.6	3.2	-0.9	-0.2
Wages per worker (FTEJ)	3.2	0.2	0.7	0.2	0.5	-0.2	0.0
Unit labour costs	2.8	-3.0	-1.6	-0.6	-0.3	-0.3	-0.1
Unemployment rate (LFS)	**12.5**	**24.8**	**26.1**	**24.5**	**22.6**	**-0.7**	**-0.9**
3. Financial balances (% of GDP)							
National saving rate	22.2	18.5	19.0	19.0	19.5	-0.5	-0.4
- of which, private saving	18.9	23.0	23.9	22.7	22.5	-0.7	-0.9
National investment rate	26.6	19.8	18.2	17.9	17.9	-0.2	-0.3
- of which, private investment	23.1	18.0	16.8	16.5	16.6	-0.3	-0.3
Current account balance with RoW	**-4.4**	**-1.2**	**0.8**	**1.1**	**1.6**	**-0.3**	**-0.2**
Nation's net lending (+) / net borrowing (-)	-3.4	-0.6	1.5	1.7	2.2	-0.3	-0.2
- Private sector	-2.6	10.0	8.6	7.2	6.8	-0.8	-1.0
- Public sector (general governm. deficit)	**-0.9**	**-10.6**	**-7.1**	**-5.5**	**-4.6**	**0.5**	**0.9**
- General gov. deficit exc. financial instit. bailout	**--**	**-6.8**	**-6.6**	**-5.5**	**-4.6**	**0.5**	**0.9**
Gross public debt	53.5	86.0	93.9	99.4	103.0	-0.3	-1.3
4. Other variables							
Household saving rate (% of GDI)	12.0	10.3	10.4	9.8	10.0	-0.5	-0.4
Household gross debt (% of GDI)	82.5	122.9	116.5	111.5	106.2	-0.7	-1.2
Non-financial coporates gross debt (% of GDP)	82.1	133.6	129.0	119.2	110.6	0.8	-0.3
Spanish external gross debt (% of GDP)	92.5	167.9	159.7	154.8	149.1	-4.7	-4.8
12-month EURIBOR (annual %)	3.7	1.1	0.5	0.5	0.7	-0.1	-0.2
10-year government bond yield (annual %)	5.0	5.9	4.6	2.9	2.7	-0.3	-0.6

Notes:
(a) Change between present and previous forecasts, in percentage points.
(b) Contribution to GDP growth, in percentage points.
Sources: 1996-2013: INE and Bank of Spain; Forecasts 2014-2015: FUNCAS.

and to 4.6% of GDP in 2015 (the official targets are 5.5% and 4.2%, respectively), above all thanks to the favourable impact of the cycle and the reduction in interest expenditure on the public debt, in conjunction with an increase in the ratio's denominator due to rising nominal GDP. The deficit provision for 2015 has included the effects of a limited personal income tax reform, the scope of which was unknown at the time of making this forecasts, so it should be viewed as being purely tentative.

In short, Spain's economic recovery is gradually gaining traction, with GDP growth picking up speed and, more importantly, jobs starting to be created. Meanwhile, private sector deleveraging is still under way, which is not incompatible with a freer flow of new credit to the sector. Financial conditions for the economy as a whole improved perceptibly as a result of both the balance sheet clean-up and recapitalisation in the domestic financial sector and international markets' greater willingness to lend. Confidence indicators are also showing a marked improvement. This all suggests that the recovery will continue and gain strength over the coming quarters.

However, recent economic conditions have been showing certain undesirable traits that are unsustainable over the medium term. The strong recovery in durable goods consumption and, particularly, investments in capital goods are driving rapid import growth, while at the same time exports have weakened due to slackening demand from emerging markets. This has translated into net exports making a negative contribution to GDP and the incipient external current account surplus narrowing. If these trends continue, the current account deficit will soon re-emerge, and with it, the tendency for the debt to grow. It is difficult to imagine a genuine recovery taking hold under such conditions. Therefore, economic policy needs to remain focused on boosting exports rather than consumption and on making progress on consolidating the public sector to eliminate the imbalances, with a view to boosting the savings capacity of the economy as a whole. The Spanish economy undoubtedly needs to raise its investment rate in order to consolidate its growth potential and create jobs, but this investment should be financed from domestic savings rather than with more external debt.